

VZCZCXRO9445
PP RUEHAG RUEHBC RUEHDE RUEHKUK RUEHMOS
DE RUEHLB #1470/01 1301004
ZNY CCCCC ZZH
P 101004Z MAY 06
FM AMEMBASSY BEIRUT
TO RUEHC/SECSTATE WASHDC PRIORITY 3460
INFO RUEHEE/ARAB LEAGUE COLLECTIVE PRIORITY
RUCNMEM/EU MEMBER STATES COLLECTIVE PRIORITY
RHMFISS/CDR USCENCOM MACDILL AFB FL PRIORITY
RUEAIIA/CIA WASHDC PRIORITY
RUCPDOG/DEPT OF COMMERCE WASHDC PRIORITY
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RHEHNSC/NSC WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 03 BEIRUT 001470

SIPDIS

SIPDIS

STATE PASS USTR
NSC FOR ABRAMS/DORAN/WERNER/SINGH

E.O. 12958: DECL: 05/10/2016
TAGS: [EFIN](#) [ECON](#) [ETRD](#) [EINV](#) [KIPR](#) [LE](#)
SUBJECT: MGLE01: CENTRAL BANK GOVERNOR DISCUSSES ECONOMIC
HEALTH AND REFORM EFFORTS

Classified By: Ambassador Jeffrey Feltman. Reason: Sections 1.4 (b) and (d).

¶1. (C) Summary. On May 9, Ambassador and Econ/Commercial Officer met with Central Bank Governor Riad Salameh to discuss the health of the Lebanese economy and the prospects of PM Siniora's economic reform program. Salameh began the meeting by briefing the Ambassador on two recent reports by the International Monetary Fund (IMF) discussing the health of the Lebanese banking sector. According to the reports, the benefits to banks of contributions to a donors' conference would likely be small, unlike the scenario following the Paris II donors' conference. Salameh was optimistic about many of the leading economic and financial indicators for the Lebanese economy, but he conceded that significant job growth could only come after serious structural reform and privatization. He stated that a transparent privatization of mobile telephones could serve as a practical reform that could regain the confidence of the Lebanese population and provide much needed momentum for further reform. Salameh told the Ambassador that the recent Libancell judgment against the GOL had adversely affected the reputation of the GOL. Salameh also briefed the Ambassador on his discussions with USG officials in Washington during his April visit. End Summary.

SALAMEH DISCUSSES
IMF REPORT CONCLUSIONS

¶2. (C) Salameh began by briefing the Ambassador on the conclusions of a confidential IMF April 2006 draft of "Lebanon: An Assessment of Banking System Soundness," and the May 3 "Summary Conclusions" of the IMF's 2006 Article IV Consultations with Lebanon. Salameh stated that Lebanese banks' return on equity and return on assets are well below regional and world averages. Salameh pointed out that the IMF didn't like the heavy exposure of Lebanese banks to the sovereign debt. According to the IMF banking system report, the large maturity mismatch between short-term deposits and long-term assets compels banks to hold large amounts of less-remunerating assets; this reduces profitability, and for this reason the profitability ratios in Lebanon are lower than in other countries.

¶3. (C) An IMF stress test of Lebanese banks suggested that banks have high exposure to interest rate risks due to maturity mismatches and a sudden increase in interest rates

would create severe stress. The IMF report stated that Lebanese banks are also very vulnerable to liquidity risks and face reinvestment risks if interest rates were to come down. In the IMF report's discussion of a proposed contribution from Lebanese banks to a Beirut donors' conference, their projections suggested that the positive effects on banks' profitability from an improvement in the macroeconomic environment due to a donors' conference is likely to be small as a result of deposit rates being projected to fall only marginally. Salameh said he would not release the conclusions of the confidential IMF report to Lebanese banks, as they would use the report to bolster their own political arguments against making a contribution to a donors' conference. According to Salameh, one of the Central Bank's next reforms will be the creation of an institution that guarantees deposits. This new configuration will receive half of its revenue from the GOL and half of its revenue from banks.

SALAMEH OPTIMISTIC
ABOUT ECONOMIC INDICATORS

14. (C) Salameh was optimistic that the Lebanese regional role in the banking sector would remain strong. He noted that there are currently five Lebanese banks in Syria, two in Jordan, two in Sudan, two in Algeria, two in Egypt, and two or three in the Gulf States. He said that changes in Lebanese law that allowed equal treatment in buying shares for Lebanese and non-Lebanese contributed to the strength in the sector. He foresees an even bigger role for big Lebanese banks in the region. Salameh noted that Audi Bank raised USD 600 million in equity, Blom Bank raised USD 300 million in equity, and Byblos Bank raised USD 400 million in equity.

BEIRUT 00001470 002 OF 003

The IMF report stressed the many strengths of the Lebanese banking system that allowed it to withstand the Hariri assassination shock, including a loyal customer base, high capital adequacy and liquidity, and low foreign currency risks.

15. (C) Salameh told the Ambassador that banks were right in their criticisms of the GOL's plan to increase the tax on interest from five to seven percent. Salameh said he was opposed to the tax on interest of five percent when it was initially proposed.

16. (C) Salameh was optimistic about several economic and financial indicators of the Lebanese economy. He estimated that, based on preliminary first-quarter figures, Lebanon would have GDP growth of 4-5 percent in 2006. He noted that direct investment was increasing, particularly new investments geared towards real estate, including construction. He told the Ambassador that consumption numbers were increasing, and tourism remains strong, with hotels fully booked. He said inflation is currently at two percent, and the GOL ran a balance of payments surplus of USD 300 million in 2005. Asset dollarization was at 72 percent and there was not an overliquidity in Lebanese pounds. Banks expect increased deposits of USD 3.5-4 billion in 2006, enough deposits to secure needed funds for financing the GOL and the private sector. Salameh also told the Ambassador that Lebanon issued a record number of licenses for construction in 2005.

STRUCTURAL REFORM AND
PRIVATIZATION NEEDED FOR JOB GROWTH

17. (C) Salameh conceded that, although many economic statistics are trending the right direction, the current Lebanese economy was not creating a sufficient number of jobs. He said structural reforms and privatization were necessary to create companies and institutions that could generate job growth. He added that a thriving private sector

would allow for taxation policies that wouldn't hurt the population further and lead to greater transparency in economic transactions. Salameh saw two reasons why Lebanon's economy should have a competitive edge: (1) Lebanon has a highly dollarized economy and the weak dollar should positively affect domestic competitiveness, and (2) Lebanon's salaries for skilled workers are the lowest in the world.

18. (C) When the Ambassador asked Salameh why there is a disconnect between the positive economic indicators and the mood of the Lebanese people concerning the economic situation, Salameh said there were two primary reasons for the current economic pessimism. First, the Lebanese are disappointed with a political class that has been "imposed" on them, in the form of what Salameh called a "self-feeding, clientele system" that inhibits people from fighting for new policies. Second, the Lebanese middle class sees many of its children without jobs. Salameh stated that although the macro-economy was in good shape and there was no economic crisis, there was not a proper distribution of wealth and insufficient job opportunities.

REFORMS THAT ARE
REALISTIC WILL BE INCREMENTAL

19. (C) When the Ambassador asked Salameh how the USG could help the GOL with its reform efforts, Salameh emphasized that positive statements by the USG about their commitment to reform in Lebanon have a positive impact on economic confidence. When asked by the Ambassador what reforms are realistic, Salameh said that the privatization of mobile telephones would be a practical action that could take place right away. He emphasized that reform had to be explained in the right way and reformers would "have to fight" for important reform actions. Salameh said that a transparent privatization of mobile telephones that prohibited any government official from subscribing could help gain the confidence of the Lebanese people and spur further reform efforts. He said a successful telecommunications privatization could allow the GOL to reduce its debt by USD 1-1.5 billion. He stated that according to a 2002 law, all

BEIRUT 00001470 003 OF 003

proceeds gained from privatization would be used exclusively to reduce the debt. He clarified his statement by saying that the proceeds of the successful privatization of Central Bank assets, such as Middle East Airlines, would go towards Central Bank funds. He further added that increased Central Bank funds allowed for increased market confidence.

110. (C) Salameh told the Ambassador that the GOL was working to satisfy the IMF's desire to see a serious commitment to reform and was also questioning potential donor nations about the possible size of future financial contributions. He said that the GOL would continue to try to implement reform measures incrementally even if a potential donors' conference were delayed beyond 2006. He said that, although the IMF was willing to suggest a formal program for Lebanon, he did not know if Lebanon was ready to accept a formal IMF program now. Salameh said that increased VAT taxes and interest rate taxes could be left for later in order to allow the population to gain confidence in the GOL, if incremental reforms such as the privatization of the telecommunications sector were accomplished successfully. When the Ambassador asked about what the 2006 budget would look like, Salameh replied that spending would most likely increase and the national debt would likely rise USD 1.6-1.7 billion.

LIBANCELL JUDGMENT HURT GOL REPUTATION

111. (C) The Ambassador asked how the impact of the Libancell judgment against the GOL had affected Lebanon. Salameh said that the lasting damage was to the reputation of

the GOL in the financial markets. He said that he would not have cancelled the bond issue that was cancelled following the announcement of the court verdict. He said that the GOL should have kept the bond issue and given the money raised to a judge to be held under a collateral account. Then the GOL should have sent a team of lawyers to work out the details.

SALAMEH DISCUSSES SIC EFFORTS

¶12. (C) Salameh told the Ambassador that when he met with Treasury officials in Washington during his recent visit, the officials were happy with the actions of Lebanon's Special Investigation Commission (SIC) to fight money laundering. He said that he had brought up two points of concern to his interlocutors in Washington: (1) Lebanon's banks are now expanding into neighboring countries whose banking standards are not up to U.S. standards, and (2) sometimes when the U.S. bans financial transactions with certain individuals and institutions the SIC has no legal authority to stop financial transactions with those individuals and institutions that do not involve a U.S. entity.

FELTMAN